UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 8th day of December, one thousand nine hundred and ninety-five.

PRESENT: HON. AMALYA L. KEARSE
HON. RALPH K. WINTER
HON. JOSÉ A. CABRANES,
Circuit Judges.

Docket no.(s): 95-4084

PHILIP MORRIS INCORPORATED,
Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent - Appelle.

Filed December 8, 1995
George Lange III, Clerk

Appeal from the United States Tax Court.

This cause came on to be heard on the transcript of record from the United States Tax Court and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ORDERED, ADJUDGED and DECREED that the judgment

of said Tax Court be and it hereby is affirmed in accordance with the opinion of this Court, with costs to be taxed against the appellant.

For the Court
GEORGE LANGE III, Clerk

By:

Arthur M. Heller
Administrative Attorney

judmnt_frm

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 508—August Term, 1995

(Argued: November 7, 1995
Decided: December 8, 1995)

Docket No. 95-4084

PHILIP MORRIS INC.,

Petitioner-Appellant,

—v.—

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

Before:

KEARSE, WINTER, and CABRANES,
Circuit Judges.

Appeal from a judgment of the United States Tax Court determining deficiencies in appellant's income tax. Appellant argues that it should be permitted to consider the repayment of certain foreign loan obligations in depreciated currency as a "discharge of indebtedness," rendering the net gain from the transactions eligible for tax deferral. We disagree and affirm.

JEROME B. LIBIN, Sutherland, Asbill & Brennan, Washington, D.C. (William S. Corey, David A. Golden, of counsel), *for Petitioner-Appellant.*

CHARLES BRICKEN, United States Department of Justice, Washington, D.C. (Assistant Attorney General Loretta C. Argrett, Gary R. Allen, Richard Farber, of counsel), *for Respondent-Appellee.*

WINTER, *Circuit Judge*:

Philip Morris Inc. appeals from a Tax Court decision (Theodore Tannenwald, Jr., *Judge*) rejecting its claim that income realized from the repayment of a foreign currency loan after the currency has depreciated qualifies as "income by reason of the discharge of indebtedness." Under earlier caselaw, the income in question would have been considered as resulting from such a discharge within the meaning of Section 108 of the Internal Revenue Code in effect for the relevant tax years. We agree with the Tax Court that the Supreme Court's decision in *United States v. Centennial Savings Bank FSB*, 499 U.S. 573 (1991), undermined that caselaw. We therefore affirm.

BACKGROUND

The facts are essentially undisputed. During the period 1980 through 1984, Philip Morris (taxpayer) borrowed and repaid foreign currency in six separate transactions. In four of these transactions, the taxpayer immediately converted the borrowed funds into U.S. dollars. The proceeds from the

remaining two loans were used to purchase certain machinery abroad. In all of the transactions the foreign currency had declined in value against the U.S. dollar by the time of repayment. The taxpayer thus repaid all of the loans in foreign currency with a lower U.S. dollar value than the U.S. dollar value of the currency when borrowed.

The specific transactions were as follows. On November 24, 1980, the taxpayer borrowed 100 million Swiss francs (SF) from Union Bank of Switzerland (UBS), repayable with interest on December 1, 1987. The funds were converted into U.S. dollars on the date they were borrowed at a rate of US $1 per SF 1.72038, for a total of $58,126,693. On September 1, 1983, the taxpayer prepaid the loan principal plus accrued interest, taking advantage of an exchange rate of US $1 per SF 2.1875.[1/] The dollar value of the principal payment was thus $45,714,286.[2/]

On December 22, 1980, the taxpayer borrowed an additional SF 125 million from UBS, repayable with interest on December 31, 1985. The proceeds of this loan were also converted to U.S. dollars on the date of borrowing, at the rate of US $1 per SF 1.81308, for a total of $68,943,455. The taxpayer prepaid the principal and accrued interest and paid a prepayment penalty on May 31, 1983. On that date the

---

[1/] The taxpayer conceded in the Tax Court that the repayments of its Swiss franc borrowings had been calculated erroneously using the dollar cost of the Swiss francs used for repayment instead of their dollar value on the date of repayment. This error was reflected in its tax returns.

[2/] On this appeal, we consider the facts as stipulated by the parties and reflected in the Tax Court's decision. We have not independently verified the stipulated figures.

exchange rate was US $1 per SF 2.1005.[3] The U.S. dollar value of the principal payment was therefore $59,509,641.

The final Swiss franc borrowing occurred on December 23, 1980. On that date, the taxpayer borrowed SF 75 million from Swiss Bank Corporation (SBC), to be repaid on December 23, 1985. The proceeds were converted on the same day to U.S. dollars at a rate of US $1 per SF 1.81310, for a total of $41,365,587. On January 7, 1983, the taxpayer prepaid the SF 75 million principal. The exchange rate on the date of repayment was US $1 per SF 1.9340,[4] giving the repayment a U.S. dollar value of approximately $38,799,731.[5]

On December 1, 1981, the taxpayer financed, in pounds sterling, 80 percent of the contract value of certain manufacturing equipment to be purchased by the taxpayer, with the financed amount to be repaid in 10 equal semi-annual installments with interest. The exchange rate between the pound sterling and the U.S. dollar on the dates the machinery was shipped generated a dollar value for 20 percent of the financed amount (representing two semi-annual installments) of $256,592. The taxpayer made two semi-annual installment payments in 1983 and two in 1984, with

---

[3] *See supra* note 1.

[4] *See supra* note 1.

[5] The Tax Court appears to have figured the repayment value using an exchange rate of U.S. $1 per SF 2.0150. That was the governing rate on December 22, 1982, when the taxpayer acquired the Swiss francs used for repayment. The taxpayer concedes that the dollar value at repayment is the appropriate measure. *See supra* note 1.

total U.S. dollar values of $215,633 and $188,410, respectively.

On September 2, 1982, the taxpayer entered into a similar transaction, again financing, in pounds sterling, 80 percent of the contract value of manufacturing equipment to be purchased by taxpayer, with the financed amount to be repaid in 10 equal semi-annual installments plus interest. On the date of shipment, 10 percent of the financed amount was equivalent to US $1,063,367. In 1983, the taxpayer made one semi-annual installment payment in pounds sterling having a U.S. dollar value of $981,144, based on the exchange rate on the date of payment. In 1984, the taxpayer made two semi-annual installment payments in pounds sterling having a total U.S. dollar value of $1,759,735, also based on the exchange rate on the dates of payment.

Finally, on February 10, 1982, a wholly owned subsidiary of the taxpayer sold to a German bank, for ultimate sale to the public, 150 million German deutsche marks (DM) of 9 1/2 percent seven-year bearer bonds, which were guaranteed by the taxpayer. The net proceeds of the bearer bond issue amounted to DM 147,888,333 after underwriting fees and other expenses. Those funds were transferred from the subsidiary to the taxpayer on a discount basis on February 16, 1982, and the taxpayer converted the marks into $62,581,611 on the same day at an exchange rate of US $1 per DM 2.36313. From March 12, 1984 through May 3, 1984, the subsidiary repurchased in the market bearer bonds with a total par value of DM 10 million, for a purchase price of DM 10,924,825 plus accrued interest. At the exchange rates prevailing on the dates of prepayments, the value of DM 10 million was $3,769,505.

The taxpayer treated the foreign exchange gain from each of these six transactions as income from "the discharge . . . of indebtedness" on its federal income tax returns. It elected to exclude those amounts from its gross income under I.R.C. § 108 and to reduce the basis of its depreciable assets under I.R.C. § 1017. The Commissioner disallowed the elections and determined deficiencies in taxpayer's income tax for both years. After an unsuccessful petition in the Tax Court for a redetermination of the deficiencies, the taxpayer took the instant appeal.

DISCUSSION

In the hands of a U.S. taxpayer, foreign currency is considered property. *See Federal Nat'l Mortgage Ass'n v. Commissioner*, 100 T.C. 541, 582 (1993). When engaging in a transaction in a foreign currency, therefore, a taxpayer ordinarily must translate the foreign currency into U.S. dollars for the purposes of calculating the U.S. tax consequences of the transaction. *See, e.g., Bernuth Lembcke Co. v. Commissioner,* 1 B.T.A. 1051, 1054 (1925); Rev. Rul. 78-281, 1978-2 C.B. 204. One consequence of this rule is that a taxpayer may satisfy a foreign currency loan with the exact sum of foreign currency stipulated and yet realize a gain or loss when the foreign currency is translated into U.S. dollars. The question presented on this appeal is whether a gain from such borrowing and repayment in depreciated foreign currency is entitled to deferral under the pre-1986 Internal Revenue Code.[6/]

[6/] The Tax Reform Act of 1986 provides that, for tax years beginning after December 31, 1986, foreign currency borrowings such as those involved in this case are governed by I.R.C. § 988, which treats foreign

(continued...)

During the tax years at issue, I.R.C. § 108 provided in pertinent part that

> [g]ross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if . . .
>
> (C) the indebtedness discharged is qualified business indebtedness.

The statutory definition of "qualified business indebtedness" includes "indebtedness . . . incurred or assumed . . . by a corporation," I.R.C. § 108(d)(4)(A), and we assume for the purposes of this appeal that the six loans at issue would so qualify. The core of this dispute is whether the taxpayer's repayments of foreign currency loans are "discharges" within the meaning of the statute, and, if they are, whether the foreign exchange gain produced is by reason of "the discharge of indebtedness."

Under the only court of appeals decision directly on point, the foreign exchange transactions in this case would each have been considered a discharge of indebtedness, and the income produced would have been "by reason of" that discharge. *See Kentucky & Indiana Terminal R.R. v. United States,* 330 F.2d 520, 523 (6th Cir. 1964). In that case, the taxpayer sold bonds denominated in pounds sterling and, after

---

[9] (...continued)
currency gain as ordinary income, I.R.C. § 988(a). *See also* Pub. L. No. 99-514, § 822(a), 100 Stat. 2373 (1986 amendment limiting Section 108 to situations in which the taxpayer is insolvent or in bankruptcy at the time of the discharge of indebtedness).

the pound had been devalued, repurchased those bonds in a combination of dollars and pounds for less than face value. The differential between the face value of the bonds and the purchase price thus consisted of two elements: first, the portion attributable to the repurchase of bonds at less than face value and, second, the portion attributable to the decline in the value of the pound sterling. The government urged the Sixth Circuit to construe only the first of these elements as income from the discharge of indebtedness under I.R.C. § 22(b)(9), Section 108's predecessor. The court refused, holding that the taxpayer would not have realized any of the second type of gain "except for the discharge of the indebtedness incurred." 330 F.2d at 523.

The Sixth Circuit noted that Section 22(b)(9) was a congressional reaction to the Supreme Court's decision in *United States v. Kirby Lumber Co.,* 284 U.S. 1 (1931), which held that a taxpayer realized taxable income when it purchased some of its outstanding bonds at a discount from the issuing price. The court pointed out that Section 22(b)(9) responded to the possibility that, under *Kirby Lumber,* a corporation might realize a taxable gain without receiving cash in hand to pay the resultant tax. *Kentucky & Indiana,* 330 F.2d at 524. The court thus held that

> [t]o require the taxpayer in the instant case to include any part of the gain realized from the purchase of its outstanding bonds here involved as taxable income for the year when such bonds were acquired, would defeat the underlying purpose of Section 22(b)(9). Neither the language of this statute nor its legislative history indicate a Congressional

> intent to exclude from the benefits of the statute any of the income attributable to the discharge of taxpayer's indebtedness, for any reason whatsoever.

Id. The Commissioner does not dispute the taxpayer's assertion that, until *Centennial Savings Bank, Kentucky & Indiana* was generally accepted as governing law.[7/]

However, we agree with the Commissioner and the Tax Court that the Supreme Court's decision in *Centennial Savings Bank,* while not expressly addressing foreign exchange transactions or the continued viability of *Kentucky & Indiana,* effectively undermined the latter decision. The issue in *Centennial Savings Bank* was whether a bank could treat funds received as penalties for customers' early withdrawal of certificates of deposit as "income by reason of the discharge . . . of indebtedness" eligible for exclusion from gross income and reduction in basis. 499 U.S. at 575. The Supreme Court responded in the negative on the ground that the depositors who withdrew their deposits and paid the penalties did not discharge Centennial from any obligation of

---

[7/] Other decisions have relied upon *Kentucky & Indiana* in holding that foreign exchange gains or losses associated with repaying an obligation in foreign currency are not long-term capital gains or losses, but rather are ordinary income or losses. *See National-Standard Co. v. Commissioner,* 749 F.2d 369, 372 (6th Cir. 1984) (loss realized in paying an obligation in foreign currency as a result of a change in exchange rates is attributable to paying the debt); *Gillin v. United States,* 423 F.2d 309, 314 (Ct. Cl. 1970) ("The [currency] conversions were not independent of, or separate from, the debt but were integral to the arrangement and formed a necessary part of it . . . . [T]here was an assumption and repayment of a debt for less than face value, resulting in ordinary gain . . . .").

the debt. *Id.* at 579. The Court explained that "[a]s used in § 108, the term 'discharge . . . of indebtedness' conveys *forgiveness of,* or *release from,* an obligation to repay." *Id.* at 580 (footnote omitted) (emphasis in original). To determine whether a release of an obligation has occurred, *Centennial Savings Bank* suggested scrutiny of both the end result of the transaction and the repayment terms agreed to at the outset of the lender-borrower relationship. *Id.* at 581. Because, in Centennial's case, the prepayment penalty income was an original term of the certificate of deposit and not the result of the release of any legal obligation, the Supreme Court held that the prepayment penalty did not constitute income by reason of a discharge. *Id.*

In the instant case, the Tax Court held that the rationale of *Centennial Savings Bank* applied and that the taxpayer's gains from the foreign currency transactions were not the result of a discharge of indebtedness within the meaning of Section 108. *Philip Morris Inc. v. Commissioner,* 104 T.C. 61, 73 (1995). In the Tax Court's view, although a satisfaction of indebtedness in depreciated currency may be the occasion for the realization of income, the income is not realized "by reason of the discharge . . . of indebtedness" under Section 108 unless there is a forgiveness or release of an obligation imposed in connection with the underlying debt. *Id.*

The taxpayer argues that the Supreme Court did not have foreign exchange transactions in mind when it decided *Centennial Savings Bank.* This may be true. Indeed, the Court's opinion appears predicated, in part, on a desire to avoid a tax windfall to those who are relieved of a debt in circumstances that generate current income. Here, in

contrast, the taxpayer has taken advantage of favorable market conditions to eliminate preexisting debt by a payment that fulfills the terms of the original debt but is functionally less than that debt. Unlike *Centennial Savings Bank*, the facts of this case are similar to those presented in *Kirby Lumber*. It therefore appears to be just the type of situation that Congress sought to ameliorate by "establish[ing] the tax-deferral mechanism in § 108 so that the prospect of immediate tax liability would not discourage businesses from taking advantage of opportunities to repurchase or liquidate their debts at less than face value." *Centennial Savings Bank*, 499 U.S. at 582-83 (citations omitted). The legislative history of Sections 22(b)(9) and 113(b)(3), the progenitors of Sections 108 and 1017, provides some support for this argument. *See* S. Rep. No. 1631, 77th Cong., 2d Sess. 77 (1942). Nevertheless, we are not at liberty to entertain the taxpayer's position in light of the Supreme Court's clear holding in *Centennial Savings Bank* that Section 108(a) requires a forgiveness or release of an obligation of the underlying debt to constitute the requisite discharge of indebtedness. 499 U.S. at 583.

One final matter remains. The taxpayer argues that if, as we have determined, the rationale of *Centennial Savings Bank* governs the disposition of this case, four of the transactions—the three Swiss franc loans and the German mark loan—fall within the requirements of *Centennial Savings Bank* because the taxpayer took affirmative action to prepay those borrowings. We disagree. In each case, the prepayment represented the fulfillment of the original obligation to repay the amount borrowed. While the repayment may have been accelerated and may have entailed negotiation over the prepayment fee and other ancillary

matters, the foreign exchange gains here resulted not from the forgiveness of an obligation to pay but from the performance of that obligation. They thus fall outside the scope of Section 108 as interpreted by *Centennial Savings Bank*.

We therefore affirm.

UNITED STATES TAX COURT

Received May 22, 1995

PHILIP MORRIS INCORPORATED, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	Docket No. 28279-92

NOTICE OF APPEAL

Notice is hereby given that petitioner, Philip Morris Incorporated, hereby appeals to the United States Court of Appeals for the Second Circuit from that part of the decision of this Court entered in the above-captioned proceeding on April 7, 1995, relating to the proper treatment of certain gains resulting from foreign currency borrowings.

May 22, 1995

Jerome B. Libin
Tax Court No. LJ0518

SUTHERLAND, ASBILL & BRENNAN
1275 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2404
(202) 383-0100

Counsel for Petitioner

UNITED STATES TAX COURT

PHILIP MORRIS INCORPORATED,	)	
	)	
Petitioner,	)	
	)	
v.	)	Docket No. 28279-92
	)	
COMMISSIONER OF INTERNAL REVENUE	)	
	)	
	)	
Respondent.	)	

DECISION

Pursuant to the opinion of the Court filed January 23, 1995, and incorporating herein the facts recited in respondent's computation as the findings of the Court, it is

ORDERED AND DECIDED: That there are deficiencies in income tax due from the petitioner for the taxable years 1982, 1983 and 1984 in the amounts of $365,554, $8,445,426 and $1,900,758 respectively.

(Signed) THEODORE TANNENWALD JR.

Judge.

Entered: April 7, 1995

Docket No. 28279-92

The parties stipulate that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this decision without prejudice to the right of either party to contest the correctness of the decision entered herein.

STUART L. BROWN
Chief Counsel
Internal Revenue Service

JEROME B. LIBIN
Counsel for Petitioner
Tax Court No. LJ0518
Sutherland, Asbill & Brennan
1275 Pennsylvania Ave., N.W.
Washington, D.C. 20004-2404
(202) 383-0100

Date: April 4, 1995

LEWIS R. MANDEL
Special Trial Attorney
Tax Court No. ML0032
1600 Stewart Avenue
Suite 601
Westbury, New York 11590
(516) 832-2400

Date: April 5, 1995

PHILIP MORRIS INCORPORATED, PETITIONER
v. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 28279-92. Filed January 23, 1995.

P borrowed in foreign currencies which it converted into U.S. dollars and later repaid the borrowings in the same foreign currency which it had purchased with U.S. dollars. P reported its gain, represented by the difference in U.S. dollars between the value of the foreign currencies at the time of the borrowings and the U.S. dollar cost of the currencies used for repayment, as income from the discharge of indebtedness and elected to exclude such income from gross income under sec. 108, I.R.C., and reduce the basis in its assets under sec. 1017, I.R.C. *Held*: P's gain does not constitute income by reason of the discharge of indebtedness eligible for exclusion from gross income under sec. 108, I.R.C. *Kentucky & Ind. Terminal R.R. v. United States*, 330 F.2d 520 (6th Cir. 1964), has been sapped of its vitality by *United States v. Centennial Sav. Bank FSB*, 499 U.S. 573 (1991).

Jerome B. Libin, William S. Corey, and *David A. Golden,* for petitioner.

Lewis R. Mandel, for respondent.

OPINION

TANNENWALD, *Judge*: Respondent determined deficiencies in petitioner's Federal income taxes for the 1982, 1983, and 1984 taxable years in the amounts of $4,594,256, $11,217,945, and $6,111,795, respectively. The parties have settled all but one issue involving the proper treatment of gains resulting from the use of foreign currency, the value of which changed in relation to the U.S. dollar between the dates of borrowings and repayments in the same currency.

All the facts have been stipulated and are so found. The stipulation of facts and the exhibits attached thereto are incorporated herein by this reference.

Petitioner is a corporation organized and existing under the laws of the Commonwealth of Virginia with its principal office in New York, New York. During the taxable years in issue, petitioner was the common parent of a group of affiliated corporations. At all relevant times, petitioner used the accrual method of accounting and filed consolidated Federal income tax returns for the taxable years before us with the Internal Revenue Service, Holtsville, New York.

Petitioner engaged in the following six transactions:

(1) On November 24, 1980, petitioner borrowed 100 million Swiss francs (SF) from Union Bank of Switzerland (UBS). The loan bore interest at 6½ percent per annum and was repayable on December 1, 1987. The proceeds were converted into U.S. dollars on the date of borrowing, at the rate of US$1 equals SF1.72038, for a total of

$58,126,692.94. On September 1, 1983, petitioner prepaid the principal plus accrued interest, without incurring a prepayment penalty. On that date, the spot rate was US$1 equals SF2.1875 so that the U.S. dollar value of the principal payment was $45,714,286. The source of the SF100 million prepayment was: (a) SF85,229,861 acquired by petitioner on May 31, 1983, and placed on deposit with UBS until the date of prepayment, which amount was part of the proceeds of six forward contracts purchased by petitioner on May 10, 1983, at a weighted average rate of exchange of US$1 equals SF2.03045218; (b) accrued interest income of SF981,250 on said deposit, converted at an exchange rate of US$1 equals SF2.1433; and (c) SF13,788,889 acquired by petitioner on September 1, 1983, which amount was part of the proceeds of a forward contract purchased by petitioner on August 18, 1983, at an exchange rate of US$1 equals SF2.1433.

(2) On December 22, 1980, petitioner borrowed SF125 million from UBS. The loan bore interest at 7 percent per annum and was repayable on December 31, 1985. The proceeds were converted on the date of borrowing at the rate of US$1 equals SF1.81308, for a total of $68,943,455.34. On May 31, 1983, petitioner prepaid to UBS the principal and accrued interest plus a prepayment penalty. On that date the spot rate was US$1 equals SF2.1005, so that the U.S. dollar value of the principal payment was $59,509,641. The SF125 million was acquired on May 31, 1983, as part of the proceeds of the SF280.6 million in aggregate forward contracts purchased by petitioner on May 10, 1983, at a weighted average exchange rate of US$1 equals SF2.03045218.

(3) On December 23, 1980, petitioner borrowed SF75 million from Swiss Bank Corp. (SBC). The loan bore interest at 7 percent per annum and was repayable on December 23, 1985. The proceeds were converted on the date of borrowing at the rate of US$1 equals SF1.81310, for a total of $41,365,586.86. On January 7, 1983, petitioner prepaid the SF75 million principal. On that date, the spot rate was US$1 equals SF1.9340. The source of the SF75 million was a SF100 million private placement issue by petitioner on December 22, 1982, when the spot rate was US$1 equals SF2.0150, so that the U.S. dollar value of the repayment was $37,220,844.

(4) On January 13, 1982, petitioner financed, in pounds sterling, 80 percent of the contract value of certain rotary tobacco-cutting machines purchased by petitioner, with the financed amount (including a 2.6-percent finance charge equivalent) to be repaid in 10 equal semiannual installments with interest at 8.5 percent per annum on the unpaid balance. The pound sterling/dollar exchange rate of the 80 percent of the contract value plus the finance charge equivalent was US$1,282,959 and of two semiannual installments was US$256,592. In 1983, two semiannual installments were paid in pounds sterling having U.S. dollar value of $215,633 based on the exchange rate on the dates of payment. In 1984, two semiannual installments were paid in pounds sterling, the U.S. dollar value of such repayment being US$188,410.

(5) On September 28, 1982, petitioner financed, in pounds sterling, 80 percent of the contract value of certain cigarette manufacturing machinery to be purchased by petitioner, with the financed amount (including a 2.6-percent

finance charge equivalent) to be repaid in 10 equal semiannual installments and interest at 11 percent per annum on the unpaid balance. The contemporaneous pound sterling/dollar exchange rate of the 80 percent of the contract value plus the finance charge equivalent was US$10,633,669, and one semiannual installment was equivalent to US1,063,367, and of two semiannual installments was equivalent to US$2,126,734. In 1983, petitioner made one semiannual installment payment in pounds sterling having a U.S. dollar value of $981,144, based on the exchange rate on the date of payment. In 1984, petitioner made two semiannual installment payments in pounds sterling having a total U.S. dollar value of $1,759,735 based on the exchange rate on the dates of payment.

(6) On February 10, 1982, a wholly owned subsidiary of petitioner sold to a German bank, for ultimate sale to the public, 150 million German marks (DM) of 9½-percent, 7-year bearer bonds, which were guaranteed by petitioner. The net proceeds of the bearer bond issue amounted to DM147,888,333.33 after underwriting and other expenses. The net proceeds were transferred from the subsidiary to petitioner on a discount basis at a 10½-percent interest rate on February 16, 1982. Petitioner received DM147,888,333.33 and was obligated to repay DM150 million. The net proceeds of DM147,888,333.33 were converted by petitioner into US$62,581,611.08 on February 16, 1982, at an exchange rate of US$1 equals DM2.36313. From March 12 through May 3, 1984, the subsidiary purchased in the market bearer bonds with an aggregate par value of DM10 million, at an aggregate purchase price of DM10,924,824.92 plus accrued interest. A portion of the funds for the repurchase of bonds was supplied

by petitioner through a series of prepayments by it aggregating DM10 million of its intercompany indebtedness to the subsidiary, plus accrued interest. At the exchange rates on the dates of prepayments, the cost of DM10 million was US$3,769,505.

In each transaction, the value of the foreign currency had decreased in value relative to the U.S. dollar between the date the borrowings were incurred and the date of repayment, so that fewer dollars were necessary to acquire the foreign currency for repayment than the U.S. dollar value of the borrowings at the time they were created.

In its consolidated returns for 1983 and 1984, petitioner treated its gain from the aforesaid use of foreign currency (hereinafter referred to as exchange gain), representing the difference between the U.S. dollar value of the foreign currency on the date of borrowing and the dollar cost of the currency used for repayment, as income from the discharge of indebtedness under section 108[1/] and reduced its basis under section 1017 by the same amount.

In the notice of deficiency, respondent disallowed petitioner's elections under section 108 and treated the amounts of gain reported by petitioner as section 61 ordinary income and not income from discharge of indebtedness eligible for such election.

Section 108 provides in pertinent part:

[1/] Unless otherwise indicated, all statutory references are to the Internal Revenue Code in effect for the years at issue, and all Rule references are to the Tax Court Rules of Practice and Procedure.

SEC. 108(a). EXCLUSION FROM GROSS INCOME.—

(1) IN GENERAL.—Gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if—

* * * * * * *

(C) the indebtedness discharged is qualified business indebtedness.

"[I]ndebtedness of the taxpayer" means any indebtedness for which the taxpayer is liable or subject to which the taxpayer holds property. Sec. 108(d)(1). Indebtedness is treated as "qualified business indebtedness" where it is incurred or assumed by a corporation which elects to treat it as such indebtedness. Sec. 108(d)(4).[2/] The amount excluded as qualified business indebtedness "shall be applied to reduce the basis of the depreciable property of the taxpayer", as provided by section 1017. Sec. 108(c)(1). Thus, section 108 does not exempt income from taxation, but defers the payment of tax.

Petitioner initially argues that: (1) For purposes of determining their U.S. tax consequences, the borrowings must be accounted for as if they were U.S. dollar borrowings; (2) it satisfied its indebtedness for fewer dollars than it originally borrowed; and (3) in this context, the classic test of income from the discharge of indebtedness has been satisfied, and consequently such income is eligible for exclusion from gross

---

[2/] Respondent does not dispute that petitioner made a timely and proper form of election.

income under section 108 and reduction of basis under section 1017. Petitioner further asserts that its exchange gain should be recomputed so as to represent the difference between the U.S. dollar value of the foreign currency on the date of the borrowings and the U.S. dollar value of that currency on the date or repayment. Petitioner also suggests, without explanation or argument, that it is entitled to recognize gain or loss on the difference between the U.S. dollar value of the foreign currency used to repay the borrowings at the date that currency was acquired and such value at the time of repayment.

Respondent argues that, because the foreign currency obligations were paid in full in the same currency, there was no "discharge of indebtedness" within the meaning of section 108 and therefore petitioner is not entitled to exclude the exchange gain from income under that section. Respondent further contends that, in any event, the exchange gain was not income from discharge of indebtedness within the meaning of section 61(a)(12), and that we should overrule our decision in *National-Standard Co. v. Commissioner*, 80 T.C. 551 (1983), affd. 749 F.2d 369 (6th Cir. 1984), and hold that the exchange gain constituted short-term capital gain measured by the difference between the U.S. dollar value of the foreign currency on the date the indebtedness was incurred and the U.S. dollar value of the foreign currency used in repayment on the date it was acquired (not the date of repayment) and based upon a holding period measured from the date the foreign currency used for repayment was acquired and the date of repayment. Respondent does not address the question of how we should treat the difference between the U.S. dollar value on the date of acquisition of the foreign currency and such value of the date of repayment.

Initially, we note that neither party disputes the proposition that exchange gain arises as a result of a transaction separate from the underlying transaction in respect of which the foreign currency or its proceeds in U.S. dollars were used, e.g., to acquire property. See, e.g., *Church's English Shoes, Ltd. v. Commissioner*, 229 F.2d 957 (2d Cir. 1956), affg. per curiam 24 T.C. 56 (1955); *FNMA v. Commissioner*, 100 T.C. 541, 583 (1993); *Levin v. Commissioner*, 87 T.C. 698, 729 n.19 (1986), affd. 832 F.2d 403 (7th Cir. 1987); *National Standard Co. v. Commissioner*, 80 T.C. at 555; *Willard Helburn, Inc. v. Commissioner*, 20 T.C. 740 (1953), affd. 214 F.2d 815 (1st Cir. 1954); H. Conf. Rept. 99-841 (Vol. II), 1986-3 C.B. (Vol. 4) 1, 662.[3/] Nor do the parties disagree that foreign currency in the hands of a U.S. taxpayer is considered property. *FNMA v. Commissioner*, 100 T.C. at 582.

We deal first with petitioner's assertion that we should treat the transactions involved herein as borrowings and repayments in U.S. dollars. Admittedly, there is language in the decided cases which lends support to this position. Thus, in *America-Southeast Asia Co. v. Commissioner*, 26 T.C. 198 (1956), the taxpayer borrowed pounds sterling to purchase

---

[3/] Under *Bowers v. Kerbaugh Empire Co.*, 271 U.S. 170 (1926), it was once uncertain whether borrowing, such as is involved herein, produced taxable gain, see, e.g., *B.F. Goodrich Co. v. Commissioner*, 1 T.C. 1098 (1943); *Coverdale v. Commissioner*, a Memorandum Opinion of this Court dated June 28, 1945, but that line of cases now holds little validity, *Vukasovich, Inc. v. Commissioner*, 790 F.2d 1409 (9th Cir. 1986), affg. in part and revg. in part T.C. Memo. 1984-611; *National-Standard Co. v. Commissioner*, 80 T.C. 551, 568-569 (Tannenwald, J. dissenting) (1983), affd, 749 F.2d 369 (6th Cir. 1984); *Willard Helburn, Inc. v. Commissioner*, 20 T.C. 740 (1963), affd. 214 F.2d 815 (1st Cir. 1954); Ravenscroft, Taxation and Foreign Currency 214 (1973).

burlap, of which it was a dealer, and realized exchange gain on the repayment of its obligation with the same amount of pounds sterling. In the course of deciding that the gain should be treated as ordinary income from the taxpayer's business of dealing in burlap and not as capital gain arising from speculation in foreign exchange separate from that business, we stated at 200:

> The end result of petitioner's purchase of burlap with borrowed pounds sterling was that it was able to purchase burlap worth $96,013.33 and subsequently settle the debt which it owed for $66,603.32. We are satisfied that the resulting gain, while measured by the difference in the value of pounds sterling at the time they were borrowed and the value when they were repaid, is a gain arising directly out of petitioner's trade or business from the settlement of a debt incurred therein *for less than its face amount.* * * * [Emphasis added.]

We think our translation of the transaction into dollars was for the limited purpose of deciding the issue of capital gain versus ordinary income from a trade or business. In this connection, we note that there is no reference in our opinion to the question whether the ordinary income constituted income from the discharge of indebtedness that could be excluded from gross income under the then-applicable sections 22(b)(9) and 113(b)(3) of the Internal Revenue Code of 1939 (the predecessors of sections 108 and 1017, involved herein). Similar reasoning disposes of Rev. Rul. 74-122, 1974-1 C.B. 21, and Rev. Rul. 78-281, 1978-2 C.B. 204,

cited by petitioner, which dealt with the measurement of foreign currency income received for the performance of services and the purchase price of property acquired with foreign currency.

In *Gillin v. United States*, 191 Ct. Cl. 172, 423 F.2d 309 (1970), the taxpayer borrowed Canadian dollars which he immediately converted into U.S. dollars for the payment of personal expenses and investments. He repaid these borrowings in the same amount of Canadian dollars which he had purchased with U.S. dollars at the time or repayment. In the interval between the borrowing and the repayment, the Canadian dollar had depreciated in value vis-a-vis the U.S. dollar. The Court of Claims held that the gain should be treated as income from the discharge of indebtedness under section 61(a)(12) and not as capital gain. In so holding, the Court of Claims stated at 423 F.2d 313: "In effect, the taxpayer borrowed United states funds, and the source of his gain was a decline in the value of the debt in terms of American dollars, enabling him to retire it for less United States currency than he received in incurring it." Here again, the issue involved the characterization of the exchange gain between two types of income for purposes of inclusion in gross income; the issue of excludability under section 108 was not involved, presumably because the borrowings did not meet the requirement of qualified business indebtedness. Moreover, we note that the Court of Claims did not say there *was* borrowing and repayment in U.S. dollars but merely stated that this is *in effect* what happened. Our view that this difference in expression should be accorded significant impact is reinforced by the fact that the court's immediately preceding sentence referred to the proximity of the conversions to the loan and repayment as making "clear that

plaintiff's intent in borrowing the Canadian dollars was to acquire United States money at once and that currency, in turn, was to be used later to buy back Canadian Funds to repay the debt, if possible at an exchange profit." *Id.* Thus, we are satisfied that the language of the Court of Claims does not inhibit our analysis of the issue of the exclusion from gross income under section 108.

Finally, we address *National-Standard Co. v. Commissioner*, 80 T.C. 551 (1983). In that case, the taxpayer borrowed Luxembourg francs to acquire a 50-percent stock interest in a Luxembourg corporation. Later, the taxpayer refinanced the loan with Belgian francs, which had the same dollar value as Luxembourg francs. After selling the stock in the Luxembourg corporation, the taxpayer purchased sufficient Belgian francs, with U.S. dollars, to repay the debt. At each step, the value of the U.S. dollar had decreased compared to both the Luxembourg and Belgian francs. In holding there was no sale or exchange of foreign currency, we stated:

> Likewise, when petitioner purchased francs to repay the Societe Generale loan, the purchased francs were transferred the same day to Societe Generale in satisfaction of the debt. Consequently, under the rationale of *Kenan v. Commissioner* [, 114 F.2d 217 (2d Cir. 1940),] no loss was realized.[12/]
>
> And yet, petitioner certainly realized an economic loss upon the repayment of each of the loans herein as a result of the currency fluctuations, which loss is recognized for tax purposes. This [exchange] loss * * * was due

to the fact that the amount of the debt itself had increased, in terms of U.S. dollars.

In short, the losses incurred herein were the result of the repayment of an indebtedness with more U.S. dollars than were originally borrowed.[13/] * * *

[12/] * * * However, the amount petitioner "realized" was not the U.S. dollar value of francs when borrowed. Rather, it was the extinguishment of a debt at a time that debt had a U.S. dollar value equal to the cost of the francs used to pay off such debt.

[13/] *This is not to say that the amount repaid was in fact more than the face amount of the debt. To the contrary, exactly what was owed, was paid*, to wit, BF250 million. Rather the U.S. dollar cost of repaying that loan had increased.

[*National-Standard Co. v. Commissioner*, 80 T.C. at 563-564; emphasis added.]

We think petitioner's reliance on the first italicized language is misplaced particularly since, although it quotes the second italicized language constituting footnote 13, it fails to discuss the impact of footnote 13. Clearly, we were attempting to reconcile the fact that there was no loss realized upon the actual satisfaction of the debt with the fact that there was an economic loss from the combined transactions. Discussion of paying the debt with more U.S. dollars was used merely to explain there was an economic loss, despite

paying back the face value of the debt. Footnote 13 specifically explains that, despite exchange loss, the face amount of the debt was paid, thus indicating that our discussion of U.S. dollars should not be interpreted as applying in a different context such as is involved herein.

In view of the foregoing, we are not disposed to deem the borrowings and repayments herein as representing only U.S. dollar transactions and ignore the fact that they were undertaken and implemented in accordance with their terms; i.e., in foreign currencies. See Miller, "Foreign Currency Transactions: A Review of Some Recent Developments", 33 Tax Law. 825, 838 (1980). But see Newman, "Tax Consequences of Foreign Currency Transactions: A Look at Current Law and an Analysis of the Treasury Department Discussion Draft", 36 Tax Law. 223, 232 (1983).

In the final analysis, our disposition of the issue before us turns upon whether we should apply *Kentucky & Ind. Terminal R.R. v. United States*, 330 F.2d 520 (6th Cir. 1964) (*Kentucky & Indiana*), as petitioner contends, or *United States v. Centennial Sav. Bank FSB*, 499 U.S. 573 (1991) (*Centennial Savings*), as respondent contends.

In *Kentucky & Indiana*, the taxpayer, in 1911, issued bonds in pounds sterling. In 1951, it purchased 438 of these bonds in the open market, paying for most of them in U.S. dollars and the remainder in pounds sterling. The excess of the face value of the bonds over the purchase price consisted of two elements: (1) The discount between the face value of the bonds in U.S. dollars and the acquisition price, and (2) the difference between the 1911 and 1951 values of the pounds sterling. The taxpayer elected to exclude such excess from gross income and reduce its basis in its assets under

sections 22(b)(9) and 113(b)(3) of the Internal Revenue Code of 1939 (the predecessors of sections 108 and 1017). Respondent allowed the election to the extent of the first element of the excess but disallowed the amount represented by the second element. The Court of Appeals for the Sixth Circuit held for the taxpayer on the ground that the exchange gain represented by the second element would not have been realized "except for the discharge of the indebtedness incurred". 330 F.2d at 523. It reasoned that the taxpayer "would derive no funds with which to pay the tax" on such gain and went on to state:

> To require the taxpayer in the instant case to include any part of the gain realized from the purchase of its outstanding bonds here involved as taxable income for the year when such bonds were acquired, would defeat the underlying purpose of Section 22(b)(9). Neither the language of this statute nor its legislative history indicate a Congressional intent to exclude from the benefits of the statute any of the income attributable to the discharge of taxpayer's indebtedness, for any reason whatsoever. [330 F.2d at 524.]

In *United States v. Centennial Sav. Bank FSB, supra*, the issue was whether a penalty for early withdrawal of time deposits, in accordance with restrictions in the agreements governing the deposits, constituted income from the discharge of indebtedness eligible for exclusion and reduction in basis under sections 108 and 1017. The Supreme Court held that it was not so eligible on the ground that the withdrawal, consisting of the face amount of the deposit less the penalty

for early withdrawal, was in accordance with the terms of the deposit, i.e., at the agreed face value under such circumstances. Petitioner argues that *Centennial Savings* did not involve foreign currency transactions, that the Supreme Court made no reference to *Kentucky & Ind. Terminal R.R. v. United States, supra*, or any other cases involving foreign currency transactions, and that it held only that a payment of a dollar indebtedness at less than its original amount in accordance with terms of repayment (a situation that did not exist in *Kentucky & Indiana*) does not give rise to income from the discharge of indebtedness within the meaning of section 108. Consequently, petitioner asserts that *Kentucky & Indiana* retains its vitality and controls our decision herein.

Petitioner unduly narrows the scope of *Centennial Savings* when it seeks to confine its impact to situations where the amount of the repayment of an indebtedness at less than its face value is "determinable under the express terms of the original borrowing documentation." The Supreme Court's articulation of the scope of section 108 goes beyond the factual context of that case. We think that the articulation rests upon a broad fundamental premise, namely:

> As used in §108, the term "discharge * * * of indebtedness" conveys *forgiveness of*, or *release from* an obligation to repay.[6/]

[6/] "Discharge" can be used to signify various means of extinguishing a legal duty. See generally Black's Law Dictionary 463 (6th ed. 1990). Thus, a debtor might be said to "discharge" his debt by satisfying it. But § 108 uses "income by reason of the discharge

> * * * of indebtedness" to refer to the change in the debtor's financial condition when the debtor is no longer legally required to satisfy his debt either in part or in full. "Discharge" in this sense can occur only if the creditor cancels or forgives a repayment obligation.
>
> [*United States v. Centennial Savings Bank FSB*, 449 U.S. at 580-581.]

In footnote 7, it concludes that "Centennial's reliance on §108 fails for a * * * fundamental reason—the absence of a 'discharge' for purposes of the statute." *Id.* at 582 n.7.

Granted that *Centennial Savings* did not expressly overrule *Kentucky & Indiana*, it cannot be gainsaid that the rationale of the Supreme Court is inconsistent with that of the Court of Appeals for the Sixth Circuit. We are satisfied that, at least as far as this case is concerned, *Kentucky & Indiana* has been sapped of its vitality. See *Vukasovich, Inc. v. Commissioner*, 790 F.2d 1409, 1416 (9th Cir. 1986), affg. in part and revg. in part T.C. Memo 1984-611 (where the impact of a Supreme Court opinion is not clearly discernible, it is up to the lower court to decide the case before it according to its reasoned "view of the way the Supreme Court would decide the pending case today"); see also *Hicks v. Commissioner*, 47 T.C. 71, 74 (1966).[4/] In the same vein, we are satisfied that, if our analysis of the language of *America-Southeast Asia Co. v. Commissioner*, 26 T.C. 198

[4/] We note that, in any event, we would not necessarily be bound by *Kentucky & Ind. Terminal R.R. v. United States*, 330 F.2d 520 (6th Cir. 1964), since an appeal in this case would not lie to the Court of Appeals for the Sixth Circuit. *Golsen v. Commissioner*, 54. T.C. 742 (1970), affd., 445 F.2d 985 (10th Cir. 1971).

(1956); *Gillin v. United States*, 191 Ct. Cl. 172, 423 F.2d 309 (1970); and *National-Standard Co. v. Commissioner*, 80 T.C. 551 (1983), is incorrect, *Centennial Savings* deprives petitioner of any support therefrom. Moreover, the Supreme Court concluded "that Congress did not intend to extend the benefits of §108 beyond the setting in which a creditor agrees to release a debtor from an obligation assumed at the outset of the relationship." *United States v. Centennial Sav. Bank FSB*, 499 U.S. at 584. This statement directly conflicts with that of the Court of Appeals for the Sixth Circuit in *Kentucky & Ind. Terminal R.R. v. United States, supra*, as to legislative intention (see *supra* p. 71).

We think the teaching of *Centennial Savings* is clear, namely that the discharge of an indebtedness may be the occasion for the realization of income but, unless there is a cancellation or forgiveness of a portion of the indebtedness not reflected in the terms of the indebtedness, such income is not realized "*by reason of the discharge* * * * of indebtedness of the taxpayer" (emphasis added) as required by section 108(a). See Ravenscroft, Taxation and Foreign Currency 215-216 (1973).

The conclusion that the *occasion* may differ from the *reason* for realization finds support in the fact that petitioner would have had no taxable gain absent its conversion of the proceeds of the borrowings to, and the obtaining of the means of repayment from, U.S. dollars. If the foreign currency had not been exchanged, and instead held in its borrowed form, petitioner would have had a loss (albeit unrealized) on the value of its currency in hand exactly offsetting the economic gain (albeit unrealized) from repayment in a devalued currency, and thus no gain or loss

for tax purposes. *Willard Helburn, Inc. v. Commissioner*, 20 T.C. 740, 743 (1953), affd. 214 F.2d 815 (1st Cir. 1954); see *National-Standard Co. v. Commissioner*, 80 T.C. at 569 n.4 (Tannenwald, J., dissenting) ("the value at the time of borrowing and the cost of acquisition would be the same"). Petitioner has taxable gain on the *occasion* of the discharge of its indebtedness but only because it exchanged the foreign currency for U.S. dollars (the *reason*).

Our interpretation of section 108 finds support in the legislative history of section 22(b)(9) of the Internal Revenue Code of 1939 (the predecessor of section 108). At the time of its initial enactment, in the Revenue Act of 1939, ch. 247, sec. 215, 53 Stat. 862, 875, the report of the House Ways and Means Committee made clear that the purpose of the section was to provide relief to a corporate taxpayer which acquired its evidences of indebtedness "at less than their fact value". H. Rept. 855, 76th Cong., 1st Sess. 7 (1939), 1939-2 C.B. 504, 507; see *Colonial Sav. Association v. Commissioner*, 854 F.2d 1001, 1005 (7th Cir. 1988), affg. 85 T.C. 855 (1985) and 87 T.C. 665 (1986); see also S. Rept. 1631, 77th Cong., 2d Sess. 77 (1942), 1942-2 C.B. 504, 564, referring to the repurchase of a corporation's "own bonds at a discount"; Report of the Staff of the Joint Committee on Internal Revenue Taxation 23 (1951), referring to a corporation which "buys back its own bonds at less than their face value". We are unimpressed with petitioner's effort to find sustenance in the fact that, in enacting section 988,[5/] the legislative history

---

[5/] For tax years beginning after Dec. 31, 1986, foreign currency borrowings, such as are involved herein, are subject to sec. 988. The borrowings are considered "section 988 [transactions]", sec.

(continued...)

indicates that section 988 "reverses the result in the *Kentucky & Indiana Terminal Railroad* case" and that business taxpayers "rely on this decision". S. Rept. 99-313 (1986), 1986-3 C.B. (Vol. 3) 1, 435, 461; Staff of Joint Comm. on Taxation, General Explanation of the Tax Reform Act of 1986, at 1, 1070, 1098 (J. Comm. Print 1987). Leaving aside the impact of the later opinion of the Supreme Court in *United States v. Centennial Sav. Bank FSB, supra*, on the 1986 legislative history, we think petitioner gives it too broad a reading. There is nothing in that history to indicate that Congress was approving public understanding or the judicial resolution of the issue before us; Congress only said that it was establishing a new set of rules, irrespective of the correctness of preexisting case law.

In sum, we hold that petitioner's exchange gain was not "includible in gross income by reason of the discharge" of its indebtedness within the meaning of section 108, and therefore petitioner is not entitled to elect to exclude such income under section 108 and reduce the basis in its assets under section 1017. Under the circumstances of this case, where, as far as we can determine, the amount to be included does not depend upon its characterization as ordinary income or short-term capital gain, we have no need to address respondent's argument in this respect. Discussion of respondent's argument would require us to revisit *National-Standard Co. v. Commissioner, supra*, a path which we are not inclined to travel under the circumstances herein. In this connection, we note that it does not necessarily follow, as

---

[2/] (...continued)
988(c)(1)(A)(i) and (B)(i), and the foreign currency gain is treated as ordinary income, sec. 988(a).

respondent appears to assert, that a holding that income does not arise "*by reason of* the discharge * * * of indebtedness" (emphasis added) requires the conclusion that it is not "income from discharge of indebtedness" under section 61(a)(12). Similarly, we find it unnecessary to consider petitioner's suggestion, see *supra* pp. 65-66, that we break the exchange gain into two parts.[6/]

In order to reflect our holding herein and the disposition of the settled issues,

Decision will be entered under Rule 155.

[6/] If we are in error as to the lack of necessity to deal with these arguments, they can be dealt with under Rule 155.

STATUTORY PROVISIONS

INTERNAL REVENUE CODE OF 1939

Section 22. * * * (b) EXCLUSIONS FROM GROSS INCOME — The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * *

(9) INCOME FROM DISCHARGE OF INDEBTEDNESS — In the case of a corporation, the amount of any income of the taxpayer attributable to the discharge, within the taxable year, of any indebtedness of the taxpayer or for which the taxpayer is liable evidenced by a security (as hereinafter in this paragraph defined) if —

(A) it is established to the satisfaction of the Commissioner, or

(B) it is certified to the Commissioner by any Federal agency authorized to make loans on behalf of the United States to such corporation or by any Federal agency authorized to exercise regulatory power over such corporation,

that at any time of such discharge, the taxpayer was in an unsound financial condition, and if the taxpayer makes and files at the time of filing the return, in such manner as the Commissioner, with the approval of the Secretary, by regulations prescribes, its consent of the regulations prescribed under section 113(b)(3) then in effect. In such case, the amount of any income of the taxpayer attributable to any unamortized premium (computed as of the first day of the taxable year in which such discharge occurred) with

respect to such indebtedness, shall not be included in gross income and the amount of the deduction attributable to any unamortized discount (computed as of the first day of the taxable year in which such discharge occurred) with respect to such indebtedness shall not be allowed as a deduction. As used in this paragraph, the term "security" means any body, debenture, note, or certificate, or other evidence of indebtedness, issued by any corporation, in existence on June 1, 1939. This paragraph shall not apply to any discharge occurring before the date of the enactment of the Revenue Act of 1939, or in a taxable year beginning after December 31, 1942.

INTERNAL REVENUE CODE OF 1954

Section 61. (a) GENERAL DEFINITIONS. — Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items: * * *

(12) Income from discharge of indebtedness.

Section 108. (a) EXCLUSION FROM GROSS INCOME.

(1) In GENERAL — Gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if —

(A) the discharge occurs in a title 11 case,

(B) the discharge occurs when the taxpayer is insolvent, or

(C) the indebtedness discharged is qualified business indebtedness.

(2) COORDINATION OF EXCLUSIONS —

(A) Title 11 Exclusion Takes Precedence — Subparagraphs (B) and (C) of paragraph (1) shall not apply to a discharge which occurs in a title 11 case.

(B) Insolvency Exclusion Takes Precedence Over Qualified Business Exclusion — Subparagraph (C) of paragraph (1) shall not apply to a discharge to the extent that the taxpayer is insolvent.

(3) INSOLVENCY EXCLUSION LIMITED TO AMOUNT OF INSOLVENCY — In the case of a discharge to which paragraph (1)(B) applies, the amount excluded under paragraph (1)(B) shall not exceed the amount by which the taxpayer is insolvent.

Section 1017. (a) GENERAL RULE — If —

(1) an amount is excluded from gross income under subsection (a) of section 108 (relating to discharge of indebtedness), and

(2) under subsection (b)(2)(D), (b)(5), or (c)(1)(A) of section 108, any portion of such amount is to be applied to reduce basis,

then such portion shall be applied in reduction of the basis of any property held by the taxpayer at the beginning of the taxable year following the taxable year in which the discharge occurs.

JUDICIARY AND JUDICIAL PROCEDURE, 28 U.S.C. (1994)

Section 1254. Courts of appeals; certiorari; certified questions

Cases in the courts of appeals may be revised by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree.